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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 503

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY

Appellant,

vs.

DIVISION OF TAX APPEALS, NEW JERSEY STATE DEPARTMENT OF TAXATION AND FINANCE AND THE STATE OF NEW JERSEY.

APPEAL FROM SUPREME COURT OF THE STATE OF NEW JERSEY

STATEMENT AS TO JURISDICTION

I. Nature of Case and Statutory Provisions Sustaining Jurisdiction

This is an appeal under U. S. Code Title 28 Section 1257 (2) (Chapter 646, Public Law 773, 80th Congress, Sec-

ond Session) from a final judgment of the Supreme Court of New Jersey dated October 17, 1949. A Petition for Rehearing was denied by the Supreme Court of New Jersey on November 7, 1949. The judgment affirmed an assessment of franchise excise taxes against The Central Railroad Company of New Jersey System for the year 1946. The appeal questions the constitutionality of the franchise tax provisions of the New Jersey "Railroad Tax Law of 1941" (Chapter 291, P. L. 1941) as amended (Chapter 169, P. L. 1942) as applied by the Director, Division of Taxation, and as construed by the New Jersey courts.

Briefly stated, the "Railroad Tax Law of 1941" lays two taxes upon railroads doing business in the State, (1) an annual property tax upon all property used for railroad purposes (Article II, Secs. 7-12; P. L. 1941, pp. 776, 777), and (2) an annual excise tax upon all railroads operating within the State for the privilege of exercising their respective franchises (Article III of the Statute, Secs. 13-15; P L. 1941, p. 777, 778). Sections 14 and 15 of the Statute and other Sections not presently involved were amended by Chapter 169, P. L. 1942. The Statute provides for a "franchise base" to be computed for each year by deducting $200,000 from the next preceding year's Net Railway Operating Income for each system and railroad not part of a system and allocating such part of the remainder to the State of New Jersey as the number of miles of track over which the railroad or system operates in New Jersey bears to the total number of miles of all track over which it operates. The "franchise base" for each year is the amount so allocated capitalized at 3 per cent. The franchise tax is assessed at the rate of 3 per cent of the excess of the "franchise base" of each system or of each railroad not part of a system over the total taxable valuation of the previous year of all classes of property assessed to and used by the railroad or system

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for railroad purposes, provided that the minimum tax shall be $4,000 or 30% of the amount of the remainder of its net railway operating income allocated to the State of New Jersey in the manner provided in section 14, whichever is greater, but in no event shall the franchise tax payable annually exceed an amount equal to 120 per cent of the total property tax levied for such year against the railroad or system.

"Net railway operating income shall be computed as total railway operating revenues from all sources, including any revenue whatever derived directly or indirectly from property which is used for railroad purposes, less costs of railroad maintenance, operation and depreciation, railway tax accruals, uncollectible railway revenues, rentals (both debits and credits) for equipment leased for less than one year or interchanged, and joint facility rents (both debits and credits), and the amount remaining shall constitute the net railway operating income hereinafter mentioned."

This statutory method for calculating Net Railway Operating Income is precisely the same method prescribed by the rules and regulations of the Interstate Commerce Commission for calculating Net Railway Operating Income.

Indeed, the only information received by the State Assessor is from the annual "Form A" report that is required to be filed within three months from the end of the year by each railroad with the Interstate Commerce Commission, a copy of which is immediately filed with the State Tax Department. Appellant is in interstate commerce operating in Pennsylvania and New Jersey. Its Form A report for the base year 1945 shows that its system Net Railway Operating Income for 1945 was $145,349. In 1945 appellant's railway tax accruals were $6,307,873. (Ap. p. 39), of which $5,321,662 were accruals of New Jersey taxes.

The Director, Division of Taxation made his assessment of franchise taxes against appellant for 1946 as follows:

He took the Net Railway Operating Income of appellant's system for the year ended December 31, 1945 as reported to the Interstate Commerce Commission	$ 145,349
to which he added the following accruals that appellant had made for New Jersey taxes in its Railway Tax Accruals account:	
Accruals for interest on delinquent taxes, and joint facility rents	494,349
Accruals for 1941 taxes reassessed and paid to the State in 1945	1,151,145
Interest paid on 1941 taxes reassessed	532,422
And arrived at a figure which he designated: Adjusted Net Railway Operating Income for System for year ended December 31, 1945 (Ap. 45a)	$2,323,265
On which he assessed an effective franchise excise tax for 1946 (Ap. 46a)	$ 422,769

It thus appears that the Director, Division of Taxation arbitrarily increased for the purposes of New Jersey taxes appellant's true Net Railway Operating Income for the base year by 1600 per cent and levied a tax against appellant nearly three times as great as appellant's true system Net Railway Operating Income for the base year as determined by appellant's Form A report to the Interstate Commerce Commission and under the New Jersey Statute.

The trustee of appellant (which was then in bankruptcy under Section 77 of the Bankruptcy Act, and which had its properties restored to it by Order of the United States District Court for the District of New Jersey at midnight October 1, 1949, a copy of which Order was filed with the New Jersey Supreme Court with the Petition for Rehearing) appealed from the assessment to the Division of Tax Appeals (formerly the State Board of Tax Appeals) as permitted by Sections 31 and 32 of the Railroad Tax Law of 1941 (Chapter 291, P. L. 1941, p. 784).

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The trustee in his Complaint and Appeal to the Division of Tax Appeals from the aforesaid assessment alleged the following grounds (Ap. p. 11a and 12a):

> "4. Chapter 291, P. L. 1941 of the State of New Jersey, as amended, under which said tax was attempted to be assessed and levied, as construed and applied by the Director, Division of Taxation, is unconstitutional and null and void for the following reasons:
>
> "(A) It unduly burdens the interstate commerce in which the Central Railroad Company of New Jersey System and the appellant was and is engaged, in violation of Article I, Sec. 8, Par. 3 of the Constitution of the United States.
>
> • • • • • • •
>
> "(C) It deprives The Central Railroad Company of New Jersey System and the appellant of their property without due process of law, in violation of the Fourteenth Amendment of the Constitution of the United States."

It was also alleged in Paragraph 3 of the Complaint and Appeal to the Division of Tax Appeals, that the assessment as made by the Director of the Division of Taxation was illegal and null and void for the following reasons (Ap. p. 10a, and 11a):

> "(D) The action of the Director, Division of Taxation in determining the adjusted Net Railway Operating Income of The Central Railroad Company of New Jersey System for the year ended December 31, 1945 to be $2,323,265, was without valid statutory authority, was arbitrary, capricious and confiscatory, and was beyond the lawful power and authority of said Director, Division of Taxation.
>
> "(E) The action of the Director, Division of Taxation in attempting to adjust the Net Railway Operating Income of The Central Railroad Company of New Jer-

sey System for the year ended December 31, 1945, by increasing the Net Railway Operating Income of the system from $145,349 as reported to be determined by the Interstate Commerce Commission pursuant to the provisions of the Interstate Commerce Act and on the basis of accounting methods prescribed and approved by the Interstate Commerce Commission, thereby a franchise excise tax was assessed against the said System in the amount of $422,769 (approximately three times the amount of Net Railway Operating Income of the System as reported to the Interstate Commerce Commission as required by law), operates as and is in fact an undue burden on the interstate commerce in which the Central Railroad Company of New Jersey System is and was engaged in violation of Article I, Section 8, Par. 3 of the Constitution of the United States. (Ap. 10a)"

The Division of Tax Appeals affirmed the assessment on January 6, 1948 (Ap. 19a). The opinion of the Board did not discuss the constitutional questions (Ap. 14a). On February 19, 1948, the New Jersey Supreme Court allowed a Writ of Certiorari to review the judgment of the Division of Tax Appeals aforesaid, and in the reasons filed March 18, 1948, for setting aside the judgment the trustee alleged the unconstitutionality of the statute, and the illegality of the assessment precisely as he did in his petition of appeal above mentioned (Ap. 3a, 4a, 5a, Para. 4, 5, and 7). The hearing on this Writ of Certiorari was held before the New Jersey Superior Court, Appellate Division (New Jersey meanwhile having adopted a new constitution which abolished the old Supreme Court and transferred its jurisdiction to the Appellate Division of the Superior Court). The Appellate Division, on March 25, 1949, entered a judgment affirming the judgment of the Division of Tax Appeals (Ap. 110a). The opinion of the court, written by Judge Bigelow, contained no reference to the questions of constitutional law that had been raised and argued. (Ap. p. 94a to 109a)

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On May 9, 1949, the trustee of the Jersey Central appealed from the judgment of the Appellate Division to the Supreme Court of New Jersey (Ap. 93a) (no Assignments of Error being required to be filed), and on the appeal argued the constitutional questions as raised before the Division of Tax Appeals and the Appellate Division. The Supreme Court in its opinion said:

> "Appellants assert the action of the Director of the Division of Tax Appeals was, in effect, an arbitrary increase of the operating income and constituted an assessment not only attributable to New Jersey but actually upon the earnings of the railroad in other states in which the system operates. It is claimed that such action constituted an unreasonable burden upon interstate commerce and operates as a denial of due process. The point is not well taken."

II. State Statute the Validity of Which Is Involved

From the foregoing it is shown that there were drawn in question (1) the constitutionality of Sections 13, 14 and 15 of the Railroad Tax Law of the State of New Jersey of 1941 as amended, as construed and applied by the Director, Division of Taxation, the Division of Tax Appeals, and the courts of New Jersey under the commerce clause and the Fourteenth Amendment of the Federal Constitution, and (2) the constitutional validity of the arbitrary and capricious action of the Director, Division of Taxation in making his assessment by increasing appellant's Net Railway Operating Income in a manner not authorized by statute or by sound accounting rules, but permitted by the New Jersey courts, so as to increase appellants Net Railway Operating Income for the base year 1945 by 1600 per cent, and levying a tax thereon that was nearly three times as great as the entire Net Railway Operating Income of the System in all states in which it did business.

The pertinent provisions of the New Jersey Railroad Tax Law of 1941 are as follows:

The statute under which the franchise excise taxes were assessed is the 1941 Railroad Tax Act (Chap. 291, P. L. 1941, as amended by Chap. 169, P. L. 1942 (R. S. 54:29A-13 et seq.)). The pertinent provisions of this statute as amended are as follows:

> "13. Franchise excise. An annual excise tax is hereby levied upon all railroads operating within this State for the privilege of exercising their respective franchises, to be computed in the manner hereinafter provided. This tax shall be in lieu of any other tax or taxes of or upon such franchises.
>
> "14. Franchise base. For the purpose of this section, net railway operating income shall be computed as total railway operating revenues from all sources, including any revenue whatever derived directly or indirectly from property which is used for railroad purposes, less costs of railroad maintenance, operation and depreciation, railway tax accruals, uncollectible railway revenues, rentals (both debits and credits) for equipment leased for less than one year or interchanged, and joint facility rents (both debits and credits), and the amount remaining shall constitute the net railway operating income hereinafter mentioned. Deductions from operating revenues for depreciation, additions and betterments, and compensation for personal services shall be subject to regulation by the commissioner, as to reasonableness of amount and appropriateness of accounting distribution. Depreciation charges shall in no instance, however, exceed the amount claimed by the railroad for depreciation in its report or reports to the Interstate Commerce Commission and fixed, or if none was claimed, then as fixed, by the Interstate Commerce Commission in determining the net railway operating income of the railroad for the year under consideration.

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"A 'franchise base' shall be computed for each year by deducting the sum of two hundred thousand dollars ($200,000.00) from the next preceding year's net railway operating income for each system, and railroad not part of a system, as above defined, and allocating such part of the remainder to the State of New Jersey, as the number of miles of all track over which the railroad or system operates in this State bears to the total number of miles of all track over which it operates. The franchise base for each year shall be the amount so allocated capitalized at three per centum (3%), * * *.

"15. Rate; computation. Subject to the minimum and maximum limits hereinafter stated, the franchise tax shall be assessed at the rate of three per centum (3%) of the excess of the 'franchise base' of each system and of each railroad not part of a system, over the total taxable valuation of the previous year of all classes of property assessed to and used by the railroad or system for railroad purposes, as finally determined pursuant to this act, provided that, except as hereinafter stated, the minimum franchise tax payable annually by such system or railroad not part of a system shall be either the amount of four thousand dollars ($4,000.00), or thirty per centum (30%), of the amount of the remainder of its net railway operating income allocated to the State of New Jersey in the manner provided in section fourteen of the act hereby amended, whichever is greater; but in no event shall the franchise tax payable annually by such system or railroad not part of a system exceed an amount equal to one hundred and twenty per centum (120%) of the total property tax levied for such year against such railroad or system under section seven of this act. * * *"

III. Dates of Judgments and Appeals

The final judgment of the Supreme Court of New Jersey, affirming the judgment of the Appellate Division, was rendered on October 17, 1949. A rehearing was denied on November 7, 1949, as above stated.

The New Jersey Supreme Court on October 31, 1949, made an order holding its mandate for forty-five days. A petition for appeal to this Court will be presented to the Hon. Arthur T. Vanderbilt, Chief Justice of the Supreme Court of New Jersey on December 12, 1949.

IV. Manner in Which Federal Questions Were Raised

The Federal questions were raised at the outset and argued throughout all the proceedings in the Division of Tax Appeals, an administrative agency, and in the old New Jersey Supreme Court, in the reasons for granting a Writ of Certiorari, and in the Appellate Division, which after the adoption of the new constitution for New Jersey took over the appellate business of the former New Jersey Supreme Court, and in the new Supreme Court of New Jersey. Precisely how the Federal questions were presented is stated *supra*, pages 5 and 6. Before each tribunal and in each court it was alleged that the provisions for assessing and levying a franchise tax in the Railroad Tax Law of 1941, as construed and applied by the Director, Division of Taxation, were null and void because they constituted an unreasonable burden upon the interstate commerce in which The Central Railroad Company of New Jersey was engaged in violation of the commerce clause of the Federal Constitution, and because they deprived The Central Railroad Company of New Jersey of property without due process of law in violation of the Fourteenth Amendment to the Constitution of the United States. Likewise before each tribunal and in each court it was alleged that the arbitrary and capricious action of the Director, Division of Taxation in increasing the Net Railway Operating Income of the Jersey Central by 1600 per cent and levying a tax against appellant nearly three times as great as the entire system Net Railway Operating Income, operated as an undue burden

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on the interstate commerce in which appellant is engaged in violation of the commerce clause, and deprived appellant of its property without due process of law.

The opinion of the Supreme Court of New Jersey, appended to this statement,* affirmatively shows that the Federal questions were presented and heard and decided by it, although the court referred only to the assessment as being valid but did not specifically mention that the statute was valid as against the constitutional objections made by appellant. It follows that the court having held the assessment valid over appellant's objections determined necessarily that the statute as construed also was valid.

V. The Federal Questions Are Substantial

The ultimate Federal questions presented to the Supreme Court of New Jersey were:

A. Whether the franchise tax provisions of the Railroad Tax Law of New Jersey of 1941, as amended, as applied by the Director, Division of Taxation, and construed by the New Jersey courts, operates as an unreasonable burden on the interstate commerce in which appellant is engaged when it levies a tax upon the exercise of its franchise in New Jersey nearly three times as great as the true Net Railway Operating Income of the entire system, leaving the railroad nothing for fixed charges, such as rent for leased roads and equipment, and interest on funded and unfunded debt.

B. The validity under the Fourteenth Amendment of the franchise tax provisions of the New Jersey statute as construed by the Director, Division of Taxation, and the New Jersey courts.

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* (Clerk's Note.—The opinion is printed as an Appendix to the Statement as to Jurisdiction in the Case of *D. L. & W. R. R. Co.* v. *Division of Tax Appeals*, No. 502, October Term, 1949, and is not duplicated here.)

C. The constitutional validity of the arbitrary and capricious action of the Director, Division of Taxation, under the commerce clause of the Federal Constitution, and the due process clause of the Fourteenth Amendment in making an assessment of franchise taxes against appellant nearly three times as great as its true Net Railway Operating Income for the year 1945.

D. Whether the effect of the action complained of is not a tax by the State of New Jersey on gross income of an interstate steam railroad derived from its operations outside New Jersey.

In sustaining the validity of the franchise tax provisions of the New Jersey statute as well as the arbitrary and capricious action of the Director, Division of Taxation, in assessing franchise excise taxes against appellant for 1946, the Supreme Court of New Jersey decided important Federal questions in a way which conflicts with applicable decisions of this Court.

The statute undertakes to determine how much of the earnings of an interstate railroad were made in the State of New Jersey by taking the Net Railway Operating Income of the system, where made in two or more states and taking as a base for taxation by New Jersey that proportion thereof which the mileage of the railroad in New Jersey bears to the total mileage of the system. This Court has held that such a method of determining the earnings in a given state of an interstate system is not *per se* unreasonable.

Atlantic Coast Line R. Co. v. *Daughton*, 262 U. S. 413 (1923);

Norfolk & W. R. Co. v. *North Carolina*, 297 U. S. 682, 684 (1936);

See: *Western Live Stock* v. *Bureau of Revenue*, 303 U. S. 250 (Stone, J.) (1938).

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Instead, however, of strictly applying this statute as it is written, the Director, Division of Taxation with the approval of the courts of New Jersey, has so applied it as to decrease the charges appellant properly made to the Railway Tax Accruals account and to increase to that extent the Net Railway Operating Income account and then to levy the tax at the rate fixed by the statute on the augmented or "adjusted" Net Railway Operating Income, with the result that nearly three times the Net Railway Operating Income of the system really earned both in New Jersey and Pennsylvania was taken by the tax.

The "Adjustments" made by the Assessor

What were the items disallowed as charges to "Railway Tax Accruals" account?

Additional taxes for the year 1941	$1,151,145
Interest thereon	532,422
(Ap. 45a, L. 4b and 4c)	
Total	$1,683,567

(The facts concerning these deductions were stipulated between the parties (Stipulation 21a-36a).)

These items were determined to be due and payable by judgment of the New Jersey Supreme Court dated October 16, 1945 (Exhibit 12, Ap. 78a) and were paid by the Trustees to the State on November 15, 1945 (Ap. 75a) upon Order of the United States District Court No. 303 made November 14, 1945 (Ap. 60a).

Stating the facts very briefly, on May 31, 1941, the State Tax Commissioner assessed property taxes against the Jersey Central under the old statute (Chapter 208, P. L. 1888 as amended and then in full force and effect) (R. S. 54: 19-1 et seq.) in an aggregate of $3,449,766.93 (Ap. 23a, Par. 4). At the time this tax was assessed the Railroad Tax Law of 1941 (Chapter 291) was being considered

by the Legislature and it was passed and approved by the Governor on July 22, 1941, and became effective immediately. Section 74 of the new Act (Railroad Tax Law of 1941) expressly cancelled and abated the taxes for 1941 assessed under the old law which were not payable until December 1, 1941, and which meanwhile had been appealed (Ap. 24a and 25a, pp. 5 and 6 of Stipulation). The State Tax Commissioner thereupon assessed taxes for 1941 against the Jersey Central under the new law and they were paid December 1, 1941 by the trustees. The amendment to the 1941 Railroad Tax Law adopted by the Legislature in 1942 (Chapter 169, P. L. 1942) required the Jersey Central to pay a retroactive franchise tax for 1941 of $239,749.80, which the Trustees promptly paid (Stipulation pp. 25 and 26, Pars. 7, 8 and 9).

Upon the enactment of the Railroad Tax Law of 1941 the City of Jersey City commenced a contest in the State courts to have it determined that the Railroad Tax Law of 1941 was unconstitutional as to the year 1941 because it abated taxes for 1941 that had been assessed against the railroads doing business in the State when the law was passed. On August 29, 1945 the New Jersey Supreme Court in *Jersey City* v. *State Board of Tax Appeals*, 133 N. J. L. 202 held that the Railroad Tax Law of 1941 *supra* with respect to the year 1941 was invalid and in violation of the Constitution of New Jersey as amounting to a donation to the railroads of that portion of the taxes assessed for 1941 under the old law which was in excess of the taxes against the railroads as assessed under the new law (Stipulation p. 26a, Par. 11). The judgment of the New Jersey Supreme Court entered on that opinion expressly held that all of the assessments of railroad property made by the State Tax Commissioner for 1941 under the old law "are, and have been since the making thereof, valid, lawful and subsisting obligations of the taxpayers assessed

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(without prejudice to any existing right of appeal therefrom), subject to credit in favor of such taxpayers against said obligations for any sums paid on account of property or franchise excise tax assessments" paid under the new law (Ap. 79a).

Interest on the back taxes so determined to be due was running at the rate of 1% per month under the New Jersey statute. The Federal Court accordingly ordered the Trustees to pay the additional 1941 taxes and interest thereon (Ap. 60a) thus determined to be due by the New Jersey Supreme Court and they were accordingly paid on November 15, 1945 as above mentioned (Ap. 75a) and were charged, as sound accounting principles and the rules and regulations of the Interstate Commerce Commission required, to the account "Railway Tax Accruals".

The other items disallowed by the Director, Division of Taxation (Ap. p. 45a l. 4a) amounted to $494,349.00 and were charged in appellant's form A Report to the Railway Tax Accrual account to the amount of $314,616.66 and to the Joint Facility Rents account to the amount of $179,732.79.

The facts with respect to these items were stipulated (Ap. 30a, et seq., Par. 19), and briefly stated are that the Jersey Central (like most of the other railroads doing business in New Jersey) had been unable to pay in full all of the very heavy taxes that had been assessed against its properties for the years 1932 to 1940 inclusive. It had contested in the courts continuously a portion of these annual taxes on various constitutional grounds, and had filed a petition in bankruptcy in 1939 when the Attorney General of the State threatened to sell its property for the payment of certain of the taxes. Contemporaneously with the passage of the Railroad Tax Law of 1941 (Chapter 291) the Legislature of the State had passed the so-called Railroad Tax Settlement Act (Chapter 290, P. L. 1941) which

offered to the railroads of the State (who then owed delinquent taxes exclusive of interest and penalties in an aggregate of more than $34,000,000.00 as of December 1, 1940) a settlement of the back taxes and interest thereon. The State Treasurer was authorized and required to accept without interest penalties installment payments of the full amount of property taxes which were due on or before December 1, 1940, under a formula which gave the Jersey Central as long as twenty years to pay up the principal of its back taxes, the State waiving interest thereon provided that the railroads filed an undertaking in writing agreeing to pay the principal of the back taxes on the installment plan within the period fixed by the State, and filed discontinuances of all contests of taxes for all years up to December, 1941. "All interest penalties upon taxes paid pursuant to this Act shall be abated and cancelled, except that in addition to installment payments, interest at the rate of three per cent per annum shall be paid annually upon the balance of delinquent taxes remaining unpaid from and after December 1, 1940 (P. L. 1941, Chapter 290, Sec. 4)."

The trustees of The Central Railroad Company of New Jersey filed such an undertaking under the Railroad Tax Settlement Act and discontinued all appeals and contests, and made payments to the State thereafter of all taxes assessed without contest, and annually accrued the interest provided by Section 4 of the said Statute above quoted. In each year they tendered to the State Treasurer the installments of principal of back taxes due under the terms of the said Settlement Act and accrued the interest at three per cent per annum that was tendered annually to the State Treasurer in the Railway Tax Accruals account.

It is stipulated that of the aforesaid items disallowed amounting to $494,349.00, $312,433.39 is interest at three per cent per annum for the year 1945 on unpaid taxes assessed against the Jersey Central for the years 1932 to

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1940 inclusive as computed under the terms of the Settlement Act, and which the trustees of the Jersey Central stipulated in writing to pay (Ap. 31a).

Two additional small items amounting respectively to $1,333.95 and $849.32 are in the same general category (See Stipulation Ap. 31a).

The last of the aforesaid items disallowed was as shown in the stipulation (Ap. 32a) a charge to account No. 541 "Joint Facility Rents" in the amount of $179,732.79 which the Jersey Central paid to the New York and Long Branch Railroad Company on August 14, 1945 on order of the United States District Court No. 297 (Ap. 67a) in discharge of the liability of the Jersey Central under an agreement of lease between the Jersey Central, Pennsylvania railroad and the New York and Long Branch Railroad Company, whereby the Jersey Central obtained the right to operate passenger and freight service over the lines of the New York and Long Branch Railroad Company (Exhibit 6, Ap. 53a). Since this amount was paid by the Jersey Central under the express terms of the operating agreement on order of the Federal Court in the year 1945, it was entered upon payment, as sound accounting principles and the rules and regulations of the Interstate Commerce Commission required, in account No. 541 "Joint Facility Rents", for the agreement with the Long Branch required the Jersey Central to make payments to the Long Branch of "all taxes, assessments, imposts and other governmental claims, demands and charges of every kind which may be levied, imposed, assessed or asserted under any present or future law by the United States or by the State of New Jersey • • •." (Exhibit 6, Ap. 53a)

The interest at three per cent for the year 1945 on the back taxes against the Jersey Central which was accrued by the Jersey Central in its accounts for 1945, in the amount of $312,433.39, was actually paid in full by the trustee in

full settlement in later years after the decision by this court in *Gardner, Trustee of the Jersey Central v. New Jersey* (1947), 329 U. S. 565; 91 L. Ed. 504.

THE DECISION BELOW

In this case the new Supreme Court of New Jersey followed the dictum of the old New Jersey Court of Errors and Appeals in the case of *Norton, Trustee of the New York Susquehanna and Western Railroad Co. v. State Board of Tax Appeals,* 134 N.J.L. 57 (1945). In that case the court affirmed franchise taxes assessed against the Net Railway Operating Income of the Susquehanna for the year 1943 as reported in its 1942 Form A. Report to the Interstate Commerce Commission. The trustee of the Susquehanna however had petitioned the State Board of Tax Appeals to allow him to deduct $75,366.92 for depreciation and $198,679.00 for tax accruals which he had not reported in his Form A. Report to the Interstate Commerce Commission. The State Board of Tax Appeals dismissed his petition. The Court of Errors and Appeals held that the taxes that the trustee sought to accrue in 1942 in fact accrued in 1941 when the litigation with respect thereto finally terminated.

Holding that the trustee having failed to accrue the taxes in the proper year 1941, the question was academic because they did not accrue in the base year 1942, the court of Errors and Appeals went further and said:

> "We hold that 'tax accruals' means the current taxes for the particular year which have been assessed in conformity with the law, e.g., the amount certified by the tax assessor * * *."

Again the court said:

> "It matters not when or where the tax accrual items are reflected on the books of the railroad compa-

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> nies, what the Interstate Commerce Commission does with the items or what its rules provided with respect to railroad bookkeeping."

The court further held that the decision of this Court in *Dixie Pine Products Co. v. Commissioner of Internal Revenue*, 320 U. S. 516, and *Security Flour Mills v. Commissioner*, 135 Fed. (2d) 165, affirmed (1944) 321 U. S. 281, would not be followed because in both cases "the federal income tax was involved and in both cases the attack was upon the validity of the tax itself, not the amount of the assessment."

The Supreme Court of New Jersey in the case at bar followed the dictum of the Court of Errors and Appeals in the *Norton* case, although it was pointed out to the court that the application of the decision in that case to the facts of the case at bar makes the franchise tax provisions of the Railroad Tax Law of 1941 unconstitutional as imposing an unreasonable burden on the interstate commerce in which appellant is engaged, and denies appellant due process of law. The Supreme Court of New Jersey also held that since the New Jersey Court of Errors and Appeals on May 3, 1946 (sub nom. *Jersey City v. Kelly*, 134 N.J.L. 239) reversed the decision of the New Jersey Supreme Court in *Jersey City v. State Board of Tax Appeals*, 133 N.J.L. 202 (*supra*, p. 14) and set aside the judgment of the New Jersey Supreme Court under which appellant's additional 1941 taxes were determined to be due and owing by the Jersey Central, and since on December 1, 1946 the Jersey Central was given credit against its 1946 taxes in the amount thus paid the State in 1945 to wit $1,683,567.00, that it was within the discretion of the State Tax Commissioner to disallow the charges that the Jersey Central had made to the Railway Tax Accrual account in 1945 of taxes that were determined in 1946 not to be due. The Supreme

Court also held in the case at bar that it was not the meaning of the Railroad Tax Law of 1941 that interest on back taxes should be charged to Railway Tax Accruals even though the Interstate Commerce Commission permitted such accrual, the Interstate Commerce Commission having determined that interest on New Jersey taxes should be deducted as Railway Tax Accruals since the Court of Errors and Appeals of New Jersey in *Wilentz v. Hendrickson*, 135 N. J. Eq. 244 (1944) and *Jersey City v. Zink*, 133 N.J.L. 437 (1945) had expressly held that the interest on delinquent taxes is a part of the tax and follows the principal.

This case differs substantially from any case heretofore before the court, as we are advised. The State statute takes as a pot for division, the Net Railway Operating Income of an interstate railway system. Appellant would not question this statute if it were applied as written, because in that event the State would be taxing its proper proportion of the interstate earnings, i. e. the proportion that the miles of track in the State bear to the total miles of track of the entire system. In *Southern Railway Co.* v. *Kentucky*, 274 U. S. 76 (1927) the tax assessment was set aside because too large a proportion of the earnings of the Southern Railway Company were taken by improperly increasing the miles of track of the Southern Railway in Kentucky, by including in the Southern Railway System the tracks of a railway that were not a part of the System. In the case at bar too large a proportion of the interstate earnings were taken by arbitrarily increasing the size of the pot. This was accomplished by the tax assessor and the courts of New Jersey totally disregarding the fact that appellant does and is required by the Interstate Commerce Commission to keep its books on the accrual system of accounting.

Under the accrual method, "in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability

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ms of indebtedness deducted though not paid; and
nnot be the case where the liability is contingent and
tested by the taxpayer," as stated by this Court in
Pine Products Co. v. *Commissioner,* 320 U. S. 516.
also:

reen Oil Soap Co. v. *Reinecke,* 36 Fed. (2d) 600
(1929);
lock & Kohner Mercantile Co. v. *United States,* 37
Fed. (2d) 877, 879, 880 (1930);
cabright Woven Felt Co. v. *Ham,* 38 Fed. (2d) 114
(1930);
ecurity Flour Mills Co. v. *Commissioner,* 321 U. S.
281;
hestnut Securities Co. v. *United States,* 62 Fed. Supp.
574, 576 (1945).

ordingly, when the trustees of the Jersey Central in
n order of the Federal Court paid the additional 1941
that were imposed by the decision of the New Jersey
me Court in *Jersey City* v. *State Board of Tax*
ls, 133 N. J. L. 202 (*supra,* p. 14), its obligation was
rue the tax to the "Railway Tax Accrual" account
ly under the rules of the Interstate Commerce Com-
n but under the rules of sound accrual accounting.
e tax, under the statute, falls annually upon the Net
ay Operating Income of the railroad its obligation was
tore the amount paid in 1945, when recovered in 1946,
same account against which it had been charged when
That is precisely the way the Jersey Central ac-
ed in this case. But the Supreme Court of New Jersey
hat for the purposes of the New Jersey taxes this
not be done; and that it was within the discretion of
irector, Division of Taxation, since the tax was held
have been due because of the reversal in 1946 of the
ent of the Supreme Court, to increase the taxes of

the Jersey Central by adding back to the 1945 earnings of the Jersey Central the payment it had made and deducted in 1945.

The Jersey Central also, in 1945, on order of the United States District Court paid to the New York and Long Branch Railroad Company $179,000 under its lease agreement, and, having paid the amount under Court order, charged it as required (I. C. C. rules and regulations) to account No. 541, Joint Facility Rents. This being an obligation of the Jersey Central under its contract, paid in 1945, had to be charged somewhere. Not only the Interstate Commerce Commission rules and regulations, but sound accounting principles required it to be charged to Joint Facility Rents Payable. The New Jersey statute, section 14, expressly permits joint facility Rents (both debits and credits) to be used in calculating Net Railway Operating Income.

The interest on back taxes amounting to $312,433.39, $1,333.95 and $849.32 was admitted by the trustee to be due and owing and was also properly accrued in 1945 and should not have been disallowed.

The effect of the action of the Director, Division of Taxation was to swell the pot of interstate earnings of appellant 1,600 per cent, and when the fixed rate tax was applied to that increased pot on the proper mileage basis the State took nearly three times the amount of the system Net Railway Operating Income, determined not only in accordance with the language of the New Jersey Statute, the rules and regulations of the Interstate Commerce Commission, but sound accounting principles as well.

It would seem that the action of the State authorities in this case results in effect in nothing less than an improper direct tax upon the gross income of interstate commerce earned in Pennsylvania as well as in New Jersey.

Fargo v. *Stevens* (1887), 121 U. S. 230, 30 L. Ed. 888;

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ostal Telegraph Cable Co. v. *Adams* (1895), 155 U. S. 688, 39 L. Ed. 311;
alveston &c. Railway Co. v. *Texas* (1908), 210 U. S. 217, 52 L. Ed. 1031;
merican Manufacturing Co. v. *St. Louis* (1919), 250 U. S. 459, 63 L. Ed. 1084;
rew Levick Co. v. *Pennsylvania* (1917), 245 U. S. 292, 62 L. Ed. 295;
tlantic Coast Line R. Co. v. *Daughton* (1923), 262 U. S. 413, 67 L. Ed. 1051;
orfolk & Western Railway Co. v. *North Carolina* (1936), 297 U. S. 682, 685, 80 L. Ed. 977, 980;
outhern Pacific Co. v. *Arizona* (1945), 325 U. S. 761, 89 L. Ed. 1915;
Iorgan v. *Virginia* (1946), 328 U. S. 373, 90 L. Ed. 1317;
reeman v. *Hewitt*, 329 U. S. 249 (1946), 91 L. Ed. 265;
entral Greyhound Lines v. *Mealey* (1948), 334 U. S. 653, 92 L. Ed. 1633.

e unconstitutional result was reached not by a strict eation of the Tax Act as written, but by capricious and ary action of the assessor, approved by the State s, through disregarding the established rules of accrual nting, and the rules and regulations which control an tate carrier. The arbitrary action of the Director nly made for tax purposes the year 1945 a good year e Jersey Central but it also necessarily imposed upon ersey Central's interstate earnings for 1946 a burden nchise taxes payable in 1946 over a hundred times as as the burden would have been had the applicable mini- tax on net railway operating revenues of $145,349 been sed. (Minimum tax $4,000; franchise tax as assessed 769 (App. 46a).) This is loading the interstate com- e in which the appellant is engaged with an intolerable en, within the meaning of Mr. Justice Bradley in

Philadelphia, Etc. Steamship Co. v. *Pennsylvania*, 122 U. S. 326, 30 L. Ed. 1200, 1205 (1887):

> "It is hardly within the scope of the present discussion to refer to the disastrous effects to which the power to tax interstate or foreign commerce may lead. If the power exists in the State at all, it has no limit but the discretion of the State, and might be exercised in such a manner as to drive away that commerce, or to load it with an intolerable burden, seriously affecting the business and prosperity of other States interested in it; and if those States, by way of retaliation, or otherwise, should impose like restrictions, the utmost confusion would prevail in our commercial affairs."

In *Hans Rees' Sons* v. *North Carolina*, 283 U. S. 123, North Carolina laid an income tax on a foreign corporation doing business within the state in proportion as the business done in the state was as to the entire business of the corporation. The evidence showed that the average income having its source in the manufacturing and tanning operations of the corporation in North Carolina was 17 per cent while the state assessed against the taxpayer 80 per cent. The statute provided that every foreign corporation should pay an annual income tax equivalent to 4 per cent of such proportion of its entire income as its gross receipts in the State is to its gross receipts within and without the state. This Court said:

> "It is sufficient to say that, in any aspect of the evidence, and upon the assumption made by the State Court with respect to the facts shown, the statutory method, as applied to the appellant's business for the year in question, operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of appropriate proportion to the business transacted by the appellant in that State. In this view the taxes laid were beyond the State's authority."

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also:
nion Tank Line Co. v. *Wright, Comptroller General of Georgia,* 249 U. S. 275 (1919).

following statement by Mr. Justice Roberts in *kill Trust Co.* v. *Pennsylvania,* 296 U. S. 113, 119; Ed. 91, 97 (1935), is pertinent:

"We give great weight to the characterization of a x, or the interpretation of a state law, emanating om the highest court of the state, but where a federal uestion is involved we are not bound by the label at- ched to the tax or the character ascribed to the law. 'e must determine for ourselves the true nature of the x by ascertaining its operation and effect."

he charges that were disallowed $1,683,567, was paid y to the State itself in 1945; $179,000, was actually ut for joint facility rents in 1945, and the interest due crued in 1945 in the amount of $312,000 was admitted ellant to be due and owing and was paid to the State r years.

Conclusion

respectfully submitted that the franchise excise tax ions of the New Jersey Railroad Tax Law of 1941 lied by the Director, Division of Taxation, and as ued by the New Jersey courts are in conflict with the erce clause of the Federal Constitution and must o it.

further respectfully submitted that from the stand- of federal law it amounts to a denial of due process and the placing of an unlawful burden on interstate erce for the tax assessor of a state arbitrarily and iously to disallow proper charges to an interstate r's accounts in such a way as enormously to increase rrier's Net Railway Operating Income in order that

the State may take more taxes, particularly where the statute gives the power to the assessor to make deductions from certain accounts but does not give him the right to make changes or alterations in the "Railway Tax Accrual" or in the "Joint Facility Rents" account.

Finally it is respectfully submitted that the franchise excise tax provisions of the New Jersey statute as applied by the Director, Division of Taxation, and as construed by the New Jersey courts are null and void as taking appellant's property without due process of law and as placing an unlawful burden on interstate commerce, and that the assessment as made was arbitrary and capricious and *per se* deprives appellant of its property without due process of law and places an unlawful burden on interstate commerce.

Respectfully submitted,

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Dated: December 12, 1949.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 503

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Appellant,

vs.

DIVISION OF TAX APPEALS, NEW JERSEY STATE DEPARTMENT OF TAXATION AND FINANCE, *et al.*,

Appellees.

APPEAL FROM SUPREME COURT OF THE STATE OF NEW JERSEY

BRIEF IN SUPPORT OF JURISDICTION

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Supreme Court of the United States

OCTOBER TERM, 1949

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, *Appellant,* *vs.* DIVISION OF TAX APPEALS, NEW JERSEY STATE DEPARTMENT OF TAXATION AND FINANCE, *et al.,* *Appellees.*	No. 503

APPEAL FROM SUPREME COURT OF THE STATE OF NEW JERSEY

BRIEF IN SUPPORT OF JURISDICTION

POINT I

Appellant Has Drawn into Question before the Supreme Court of New Jersey the Validity of a State Statute.

It is and has consistently been the claim of appellant that the Railroad Tax Act of New Jersey, Ch. 291, P. L. 1941, as amended by Ch. 169, P. L. 1942, is unconstitutional as construed and as applied to the facts presented by the record of this case. Such a claim gives this Court jurisdiction on direct appeal under 28 U. S. C. § 1257 (2) even though the appellant does not allege the total invalidity of the statute under attack. *Dahnke-Walker Milling Co.* v. *Bondurant,* 257 U. S. 282 (1921); *Fiske* v. *Kansas,* 274 U. S. 380 (1927); *Blodgett* v. *Silberman,* 277 U. S. 1 (1928).

In the *Silberman* case the State of Connecticut assessed a Transfer Inheritance Tax upon the decedent's interest in a New York partnership. The case was viewed as drawing into question the validity of a statute as construed and applied even though the constitutional problem arose, not by reason of the wording of the statute or any judicial gloss imposed thereon, but rather because of its application by the local officers to the particular facts of the case, and a direct appeal was allowed. It is, therefore, of no consequence here that appellant urged below the severability of the unconstitutional construction placed upon New Jersey's Railroad Tax Act by the tax assessor and the New Jersey Courts. It suffices for the purpose of the present proceeding that appellant has claimed that a particular construction and application of the statute conflicts with the Federal Constitution.

The only question then remaining is whether the Supreme Court of New Jersey was sufficiently apprised of appellant's claim to afford that Court the opportunity of ruling upon it. Appellant's jurisdictional statement and the appendix submitted therewith show that the pleadings in the Division of Tax Appeals and in the Appellate Division of the New Jersey Superior Court clearly and precisely and in so many words alleged that the *construction* of the statute adopted by the tax assessor was unconstitutional. Jurisdictional Statement, page 10. These pleadings were before the State Supreme Court as part of the record in the instant case. It is well settled that a federal question is sufficiently presented below if the pleadings in the case clearly raised it. *Magwire* v. *Tyler*, 8 Wall. 650 (U. S. 1869); *American Sugar Refining Co.* v. *Louisiana*, 179 U. S. 89 (1900); accord, *Williams* v. *Kaiser*, 323 U. S. 471 (1945). The respondents, however, have taken the position that appellant's refusal to urge the total invalidity of the Railroad Tax Act constitutes a failure to urge the invalidity of a statute or of a statutory construction. In so contending they have ignored the pleadings of record in the instant case. They have, moreover, sought to substantiate their

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m by reference to matters which are not of record here. ey have quoted a portion of appellant's brief in the preme Court of New Jersey. It is our understanding of settled rule in this Court that the briefs and arguments counsel below may not be considered in determining the stence or absence of appellate jurisdiction. *Lynch* v. *w York ex rel. Pierson*, 293 U. S. 52 (1934).

It might be objected that this settled rule should not ly to such matter as the "Statement of Questions Pre- ted". See Respondent's Statement Opposing Jurisdic- n, Pages 4 and 5. Despite the importance which the rule the New Jersey Supreme Court attaches to the State- nt of Questions Presented, appellant submits that no rule hat Court nor any legislation of the State of New Jersey kes such Statement of Questions Presented part of the ord itself. Therefore, upon the authority of *Fisher's sor* v. *Cockerell*, 5 Pet. 248 (U. S. 1831) this Court should line to treat the Statement of Questions Presented as record for determining its own jurisdiction. In that e it was held that although pleadings are part of the ord at common law this Court will not treat an assign- nt of error from an inferior State Court to the ultimate urt of review within the State as establishing that federal stions were presented below unless such assignments of or are expressly made part of the record by a state tute.

In the event, however, that this Court should be dis- ed to look to the briefs of counsel in determining its own isdiction, appellant then submits that the briefs filed ow support jurisdiction in the instant case. We have eady seen that the pleadings draw into question the idity of the statute. It is true that the Statement of stions Presented in appellant's brief in the Supreme urt of New Jersey does not use any such form of words "the statute is unconstitutional". Nonetheless, an ex- ination of the record and of all the briefs submitted arly shows that constitutionality of the statute as such

and not merely validity of the assessment was in issue and was fully argued. At page 18 of appellant's brief the general heading for Point I of the argument was stated as follows:

> "The construction of the 1941 Railroad Tax Act as made by the Director, denies appellant due process of law, and imposes an unconstitutional burden on the interstate commerce in which the appellant is engaged."

The answering brief of Respondent, State of New Jersey met appellant's brief upon this ground and beginning at Page 30, specifically argued the issue under a point heading reading as follows:

> "The New Jersey statute does not impose an unconstitutional burden on interstate commerce and does not deny the Appellant due process of law."

The answering brief of Respondent City of Jersey City also argued this issue beginning at page 15 under the following point heading:

> "The construction of the 1941 Railroad Tax Act by the Director of the Division of Taxation does not violate any provision of the Federal Constitution."

The respondent in its statement opposing jurisdiction has relied upon the asserted rule that an attack upon a specific assessment under a tax law does not create a case within the appellate jurisdiction of this Court. Appellant submits that the cases cited in support of this supposed rule do not justify respondent's position. The real principle involved in such cases as *Wilson* v. *Cook*, 327 U. S. 474 (1946) and *Charleston Federal Savings and Loan Association* v. *Alderson*, 324 U. S. 182 (1945) is that an attack directed merely to the assessment cannot sustain appellate jurisdiction where the attack may have been predicated upon some illegal act of the assessing officer (*e.g.*, systematic discrimination in valuation of property) rather than

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upon the necessary operation of the statute as construed and applied by the Courts of the State. This vice does not inhere in the case at bar. As pointed out above, appellant has left no doubt as to the basis for its constitutional claim. Appellant has always asserted that it is the construction of the statute, and not merely the action of the assessing officer, which denies it a federal right.

Similarly, the case at bar is not ruled by *Memphis Natural Gas Company* v. *Beeler*, 315 U. S. 649 (1942). In that case appellant had alleged in the State Court merely that the assessment and the threatened levy violated its rights under the Commerce Clause. In the instant case appellant has specifically pointed to the statute as impairing its rights.

Respondent has also relied upon *Ferry* v. *King County*, 141 U. S. 668 (1891) and *French* v. *Taylor*, 199 U. S. 274 (1905). In the former case, appellant merely sought an adjudication by this Court as to whether the Supreme Court of Washington had correctly interpreted the intention of the old Territorial Legislature as expressed in its practice act. In the case at bar, appellant can no longer question the construction which the Supreme Court of New Jersey has placed upon the Railroad Tax Act; rather, appellant denies the power of the State to enact and enforce the Act as so construed.

In the case of *French* v. *Taylor*, appellant attacked a tax deed upon the ground that it had been issued under a form of procedure which denied him due process of law. Although Mr. Chief Justice Fuller stated in the opinion that the case was one in which the validity of a statute had not been drawn in question, appellant respectfully submits that, upon its own opinion, the Court decided only that the claim of due process there made did not present a substantial federal question. In the light of precedents cited by appellant going to support the jurisdiction of this Court in the case at bar, *French* v. *Taylor* should not be considered as authorizing a dismissal.

The record in the case at bar establishes that appellant has specifically and clearly, and conformably to the decisions of this Court, drawn into question before the Supreme Court of New Jersey the constitutionality, under the Commerce Clause and the Fourteenth Amendment, of the Railroad Tax Act of 1941 as construed and applied by the State Court. In the event, however, that this Court should determine otherwise, appellant requests that the moving papers be considered as a petition for *certiorari* in conformity with Section 2103 of the Judicial Code.

POINT II

The Federal Questions here Presented are Substantial.

Introductory

Respondent in its motion to dismiss or affirm has argued that the tax law here under consideration must be sustained for the reason that the franchise tax imposed thereby is merely a tax in lieu of general property taxation. It places its entire reliance upon *Postal Telegraph Cable Company* v. *Adams*, 155 U. S. 688 (1895). Appellant respectfully submits that the franchise excise tax imposed by Article III of Chapter 291, P. L. 1941, as amended by Chapter 169, P. L. 1942, does not in fact impose a tax in commutation of property taxes and for this reason the authority cited by the respondent is inappropriate. We contend that the tax levied under the statute as construed is in form as well as in fact a direct tax on gross revenues derived from interstate transportation. It is, therefore, a prohibited burden upon interstate commerce. We respectfully submit that the Railroad Tax Act of 1941 as construed and applied by the Supreme Court of New Jersey falls within the ban which this court has always maintained against state taxes, whether apportioned or not, which seek to reach gross receipts derived from interstate transportation.

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A.

he New Jersey Railroad Franchise Excise Tax is not a mutation of Taxes upon Property.

he contention now made by the Attorney General of State of New Jersey would seem to be at variance with haracterization which the Legislature and the courts e state have placed upon this tax law. It is provided ection 13 of Chapter 291, P. L. 1941 that the franchise s levied upon the railroads for the privilege of exercis- heir franchises within the state. The Supreme Court ew Jersey, in the opinion now under appeal, has charac- ed the franchise tax as follows:

> "The tax was *not a property tax* upon the net income itself but rather an excise tax measured by the net operating income of the preceding year . . ." (Italics supplied) (ll. 1 to 4, p. 35, Appendix to Jurisdictional Statement in No. 502)

omenclature aside, however, the franchise excise tax ot be considered as a commutation of property tax for eason that the property value of the franchise is already d. This is accomplished by attributing going-concern e to the various items of real and tangible personal erty which are taxed under Article II of the Railroad Act.

nder the system of Railroad taxation in effect in the e of New Jersey until enactment of Chapter 291, P. L. , all railroad property was divided into four classes each class was required to be assessed and returned for tion separately. Ch. 208, Section 3, P. L. 1888, as nded, N. J. R. S. 54:22-1 (1937). This Act specifically ired that the railroad franchise, which was included in so-called Class IV property, should be evaluated sepa- ly and apart from the tangible property. The tax ssors were forbidden to value tangible items with refer- to their going-concern value. *Long Dock Company* v.

State Board of Assessors, 78 N. J. L. 44, 73 Atl. 53 (Sup. Ct. 1909), *aff'd*, 79 N. J. L. 604, 80 Atl. 1135 (E. & A. 1910).

Neither the legislature nor the courts of the state were unaware that the property value of a franchise may be reached by assessing tangible items at their going-concern value. In fact, the statements of the Supreme Court in the *Long Dock* case *supra*, at pages 52-53, 73 Atl. at 56-57, recognized that the property value of the franchise and the going-concern value attributable to the tangible property are interchangeable concepts. The reason that the franchise was required to be assessed independently rather than as an element in the value of the other property was that the statute allowed taxes upon right of way, rolling stock and franchise to be retained for state uses while taxes assessed by the state upon so-called second class railway property, consisting primarily of terminal lands and facilities, were to be given to the local taxing district within which the second class property lay. Ch. 208, Sec. 11, P. L. 1888, as amended, N. J. R. S. 54:24-6, 54:24-11 (1937); see *Long Dock Company* v. *State Bd. of Assessors, supra*, at page 48, 73 Atl. at page 55.

The Railroad Tax Act of 1941, Ch. 291, P. L. 1941, which superseded the Act of 1888, made no express provision in Article II thereof, which levied a general property tax on all property used for railroad purposes, for a property tax upon the value of franchises exercised within the state. It might therefore appear that the legislative intention was to commute this particular property tax by imposing, in lieu thereof, the franchise excise in Article III. Nonetheless, appellant submits that the systematic practice of the tax assessors, as sanctioned by the Division of Tax Appeals, has been to assess a general property tax under Article II upon the franchise value. This has been accomplished by assessing real and tangible personal property at its going-concern value.

This practice appears to have arisen almost contemporaneously with the effective date of the Railroad Tax Act of 1941. It received sanction in the case of *Pitney* v.

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Kelly, 21 N. J. Misc. 405, 422, 34 A.2d 547, 556 (St. Bd. of Tax App. 1943). It is most clearly shown, however, in the recent case of *Erie Railroad System* v. *Walsh*, 26 N. J. Misc. 81, 57 A.2d 217 (Div. Tax App. 1948). In that case the railroad contested the amount of the assessment on various classes of its property. As to Class I, or right-of-way property, the Division said:

> "The Director properly valued these lands in the physical condition in which they were held by Erie, taking into consideration work done on the land such as clearing, grading and grubbing. See *Borough of Emerson* v. *State Board*, 6 N. J. Misc. R. 326; 141 *Atl. Rep.* 23. In addition, he ascribed to these parcels a factor of value inherent in them by reason of the particular purpose which they served, namely, as the right-of-way of a going railroad company.
>
> "Erie's witnesses ignored the foregoing considerations necessary for the determination of true value." (26 N. J. Misc. at p. 85, 57 A.2d at p. 220).

A bit further on in its opinion, the Division said, in discussing the proper method of assessing Class II, or terminal facility property, the following:

> "• • • But none of the witnesses [for appellants] in valuing the terminal as a whole considered it from the standpoint of its contribution of value as a waterfront terminus 'assembled and peculiarly adaptable' to the business the terminal serves. See *Long Dock Co.* v. *State Board of Assessors, supra. Additionally, none of the witnesses for Erie or Jersey City considered the value of the terminal from the standpoint of its contribution to the total value of the trunk line railroad system of which it forms a part.*" (26 N. J. Misc. at pp. 94-95, 57 A.2d at p. 225) (Italics supplied)

Thus it clearly appears that the Division has sanctioned taxation of railway property at going-concern value under Article II of the 1941 Act. Of course, this analysis of the history of property assessment in New Jersey is not printed here with the intention of asking the court to correct and revise the attitude of the Division of Tax Appeals toward

the New Jersey railroad tax law. Rather, we wish to point out that contemporaneously with the enactment of Chapter 291, P. L. 1941, which omitted from Article II thereof any provision for taxation of franchise value, the assessing officials adopted a practice, at variance with the established valuation practice, whereby they have imposed a property tax upon the value of the railway franchise in New Jersey. Appellant respectfully submits that this makes it impossible to characterize the franchise excise tax imposed by Article III of the Railroad Tax Act as a commutation of property taxes.

Respondent has urged that the language of the statute itself clearly establishes the "in lieu" character of the tax in question. We submit that respondent has placed an erroneous construction on the "in lieu" provisions of the Railroad Tax Act.

The Act of 1888, Ch. 208, Sections 1 and 2, P. L. 1888, as amended, N. J. R. S. 54:20-2 (1937) provided that taxes imposed thereunder should be in lieu of all other taxes on the property reached by that act. The Railroad Tax Act of 1941 provides in Section 11 that the property tax imposed by Article II shall be in lieu of all other state or local taxation of or measured by property taxable thereunder except assessments for benefits. Similarly, Section 13 provides that the franchise excise tax shall be in lieu of any other tax or taxes of or upon such franchises. A consideration of these provisions in the light of the tax history of New Jersey shows their intention quite plainly. The state has traditionally treated railroad and canal companies as a distinct class for tax purposes. It has always been deemed advisable as a matter of policy to exempt such companies from the general tax laws of the state and to subject them to revenue acts directed to their special business problems. Indeed this is clearly demonstrated in the history of the Railroad Tax Act of 1941, since, as pointed out both by appellant and respondent, the purpose of the new act was to make taxation more responsive to fluctuations in railway revenues. When this is kept clearly in

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mind, it becomes evident that the purpose of the "in lieu" provisions of Articles II and III is to continue the traditional exception of railroad taxation from the general revenue laws of the state. In view of this, and in view of the practical construction which the taxing authorities have placed upon the property tax levied under Article II, it can not be said that the "in lieu" provisions of Article III have any reference to the interrelationship of taxes imposed upon railroads by the Act of 1941. Respondent's assertion that the franchise excise tax is in lieu of property taxes, therefore, not only fails to find support in the language of the statute itself, but it is also affirmatively refuted by the history of assessment under this Act.

B.

The New Jersey Railroad Franchise Excise Tax Must be Characterized as a Direct Tax upon Gross Receipts from Interstate Transportation.

Section 13 of the Railroad Tax Act of 1941 thus describes the tax there levied:

> "An annual excise tax is hereby levied upon all railroads operating within this State for the privilege of exercising their respective franchises, to be computed in the manner hereinafter provided."

Presumably, the franchise here sought to be taxed is the privilege of doing a purely local transportation business. At any rate, appellant in fact does local business, and has no standing to challenge the statute as written.

It is at once apparent however, from a reading of Section 14 of the Act, that the franchise excise base, and therefore the amount of the tax, will be directly proportional to the amount of the road's revenue (derived from both local and interstate business) allocated to New Jersey by the statutory formula. Its effect then is identical with the practical effects of a tax levied directly upon the revenue itself.

Appellant would have no quarrel with the Statute if it were construed and applied so as to reach only that sum which, under sound accounting technique, could be regarded as the net operating income remaining in the hands of the road. The constitutionality of such a tax on or measured by net income is well established. E.g., *Atlantic Coast Line Railroad* v. *Daughton* 262 U. S. 413 (1923).

However, appellant submits that the Courts of New Jersey have so construed the Statute as to make gross receipts the revenue component of the tax base formula. In order to demonstrate this, it is necessary to examine the items of deduction claimed by appellant in the instant case and the attitude which the courts of New Jersey have consistently taken toward such claims. The details as to appellant's claimed deductions are set out in the Jurisdictional Statement at pages 13 through 18 and we shall therefore not repeat them here.

The liability to pay these items was finally determined by judicial decision (except in the case of the settlement payments which were payable in installments by contract with the State pursuant to the Railroad Tax Settlement Act, Ch. 290, P. L. 1941) after litigation.

There can be no doubt that under any recognized system of accounting the items here in question were properly chargeable as deductions in the year when appellant charged them. The authorities which support appellant's procedure are set out at pages 19 through 21 of the Jurisdictional Statement.

Upon what grounds, then, have the Courts of New Jersey held the items here in question to be improper deductions for purposes of the Franchise Excise Tax?

It is apparent from the opinion of the Supreme Court here on appeal and from the opinion of the old Court of Errors and Appeals in *Norton* v. *State Board of Tax Appeals*, 134 N. J. L. 57, 45 A. 2nd 799 (E. & A. 1946), that the ground of decision was essentially unrelated to the con-

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cept of net income in the accounting sense. In the opinion of the Supreme Court here on appeal the Court said the following things:

> "The argument of appellants proceeds on the hypotheses that the Act of 1941 required the State Tax Commissioner to allow as deductions in determining the next preceding year's net operating income any amounts of back taxes permitted by the Interstate Commerce Commission to be included in current operating income accounts. This interpretation would defeat the legislative purpose. It would put a premium on defaults in the payment of taxes by thereby decreasing the tax burden." • • •
>
> "We re-affirm what was said in *Norton* vs. *State Board*, supra, at p. 63 'When the Legislature used the words 'railway tax accruals' it meant something more than mere Interstate Commerce Commission permission to include an item in a bookkeeping account or a report. It meant something specific. It meant the type of item that on the date of the passage of the act went into such account as a matter of course. *It meant current taxes.*" • • • (Italics added)
>
> "The action of the Interstate Commerce Commission in permitting the Lackawanna to allocate the unpaid and unapproved portion of the taxes for 1934 to 1940 in the years 1941 to 1944 has no bearing upon the meaning and intent of our statute. The returns made to the Interstate Commerce Commission are not made for the purpose of taxation under the State statute. The holding of the former Court of Errors and Appeals in the *Norton case* relative to this point is dispositive of it." (Jurisdictional Statement in No. 502, Appendix, pp. 35, 37 and 38)

In the *Norton* case, the Court said:

> "To determine the legislative intention as to the statute under consideration we must look to the dates, July 22, 1941 and May 8, 1942, when the original act and the amendment were approved. During all of the period from 1932 to 1940 that railroad taxes were being contested and litigated certain

companies accrued all of their current taxes in the years they were levied, while others accrued only the uncontested portions thereof. There was no uniformity. The only thing that is certain is that any company was permitted, as a matter of course, to accrue the whole of the tax in the year in which it was levied, notwithstanding the dispute. *Any rule which would now allow a company to accrue a portion of back taxes would not work for uniformity.*" • • •

"Net operating revenue, *to the minds of the members of the legislature and to the mind of the layman*, without doubt includes a charge for taxes for the year in question, not taxes for years in the past." • • •

"Much reliance is placed by the respondent and the intervenors on the opinion of the United States Supreme Court in *Dixie Pine Products Co.* v. *Commissioner of Internal Revenue, 320 U. S. 516, 64 S. Ct. 364, 88 L. Ed. 270* and on *Security Flour Mills Co.* v. *Commissioner of Int. Rev., 321 U. S. 281, 64 S. Ct. 596, 88 L. Ed. 725,* which followed it. Our Supreme Court used these cases to buttress its opinion. They do not appear to us to be in point. The federal income tax was involved and in both cases the attack was upon the validity of the tax itself, not the amount of the assessment. A holding in a federal income tax case based solely on the construction of the Federal Revenue Acts is not controlling in construing a state law enacted for an altogether different purpose." (Italics added) (134 N. J. L. at pp. 62-63, 64 and 65, 45 A.2d at pp. 802, 803)

Appellant submits that the quoted portions of the opinions establish that the courts in deciding these two cases were not motivated solely or even primarily by a desire to reach a realistic definition of railway net operating income, or to treat the statutory language as intending to tax only that portion of the gross revenues from transportation operations which might properly be said to remain as operating profit in the hands of the railroad. Rather, these opinions show that the highest courts of the State of New Jersey have regarded the policy of uniformity as of over-

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riding importance and that they have construed net income with an eye more to the prevention of any possible tax avoidance than with an eye to ascertaining the true system net operating income of an interstate railroad. In short, appellant submits that in construing the Railroad Tax Act of 1941, the Courts of New Jersey have been essentially indifferent to net railway operating income as an accounting concept and that in order to spare the tax administrator the task of determining in each case whether a claimed deduction from gross operating income was legitimate, it has established a purely arbitrary rule which in the case at bar has resulted in a tax on appellant's gross operating income. The result of the decision of the Supreme Court of New Jersey is that the tax may be levied upon revenues from interstate commerce whether or not the operation of the railway has produced net operating income.

That the tax has so operated is dramatically shown at pages 3 and 4 of this appellant's Jurisdictional Statement. In 1945 the Central system reported to the I. C. C. a net operating income of $145,349.00. It should be noted that this was the income for the system as a whole and not merely the fraction allocable to New Jersey. In 1946 because of the deductions disallowed by the Director of the Division of Taxation the road was charged with a franchise excise tax of $422,769.00, based supposedly on net operating income of the previous year. Thus, the Central's franchise tax for New Jersey alone was almost three times as great as its entire system net railway operating income for the tax base year. A tax which operates in this way has all of the vices inherent in a tax which is baldly stated to be on gross receipts. As pointed out by Mr. Justice Pitney in *United States Glue Co.* v. *Oak Creek*, 247 U. S. 321, 328 (1918):

> "The difference in effect between a tax measured by gross receipts and one measured by net income, recognized by our decisions, is manifest and substantial, and it affords a convenient and workable basis of distinction between a direct and immediate burden

upon the business affected and a charge that is only indirect and incidental. A tax upon gross receipts affects each transaction in proportion to its magnitude, and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profit and loss, or to so diminish the profit as to impede or discourage the conduct of the commerce. A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large. Such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the states are not exempted by the Federal Constitution because they happen to be engaged in commerce among the states."

In short, the franchise excise tax levied by Article III, Chapter 291, P. L. 1941, as construed by the New Jersey courts, must be characterized as a gross receipts tax. As appellant will demonstrate in Part C, *infra*, the decisions of this Court require that Chapter 291, P. L. 1941, as construed and applied by the Supreme Court of the State, be declared unconstitutional.

C.

The Franchise Excise Tax Imposed by Ch. 291, P. L. 1941, as Construed and Applied, is in Conflict with Applicable Decisions of This Court.

Appellants do not dispute that if the statute were applied as written there would be no question as to its constitutionality. As written, the statute manifests an apparent intention to reach merely the net railway operating

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income produced in the State of New Jersey and remaining in the carrier's hands after all proper operating charges have been deducted or paid. Such a tax is of undoubted validity.

Memphis Natural Gas Company v. *Beeler*, 315 U. S. 649 (1942);
Atlantic Coast Line Railroad v. *Daughton*, 262 U. S. 413 (1923);
United States Glue Company v. *Oak Creek*, 247 U. S. 321 (1918).

We have already seen, however, that the tax here under consideration must be characterized as an attempt to reach directly a part of the appellant's entire gross receipts from interstate commerce. Viewed in this light, the instant case falls squarely within the express facts and holdings of two decisions of this Court.

The first of these is *Galveston, Harrisburg & San Antonio Railway* v. *Texas*, 210 U. S. 217 (1908). In that case the State of Texas levied a tax upon the gross receipts earned by railroad corporations operating within the State. Since the appellant in that case had no trackage outside of Texas, the tax was assessed against its entire receipts. It was therefore not necessary to point out in the opinion that the tax statute was directed only to that proportion of a railroad's gross receipts which its trackage within the State bore to its entire trackage. Nonetheless, such was the fact. The tax presented for adjudication was an apportioned gross receipts tax upon interstate transportation. See Powell, *More Ado About Gross Receipts Taxes*, 60 HARV. L. REV. 501, 511-512 (1947). This Court found that the Texas gross receipts tax not only made no attempt to use gross receipts as a measure of the going-concern value of the company, but that it was a tax in addition to a general property tax which reached the going-concern value. The court therefore ruled that the tax under consideration was no more than an attempt to levy toll upon the doing of interstate business, and directly in proportion to the volume of

business done. This being so, the tax was necessarily unconstitutional. Since appellant in the instant cases has shown the New Jersey Franchise Excise Tax on railways to be, both by intention and operation, a tax in addition to the general property tax upon going-concern value, we respectfully submit that the case now at bar is governed by the *Galveston Railway* case.

The instant case is moreover identical with *New Jersey Bell Telephone Company* v. *State Board of Taxes,* 280 U. S. 338 (1930), where the State of New Jersey had levied upon all corporations using the public streets a franchise excise to be measured by that proportion of the gross receipts from all sources which their miles of lineage located upon public streets or highways within the State of New Jersey bore to their total miles of lineage everywhere. The point in dispute was the constitutional validity of that tax when it was sought to be levied against any fraction of the appellant's gross receipts from interstate communication. Looking to and interpreting the decisions of the New Jersey Court of Errors and Appeals, this Court found that the tax was not intended as a tax upon property but was rather a direct license tax. Therefore, upon the authority of such cases as *Philadelphia & Southern Mail Steamship Company* v. *Pennsylvania,* 122 U. S. 326 (1887) and *Galveston, Harrisburg & San Antonio Railway* v. *Texas, supra,* this Court invalidated the New Jersey Franchise Tax there in dispute. This Court also found that the apportionment of gross earnings was upon its face an unreasonable and inappropriate measure of the value of the property right which the State contended it was attempting to reach. The same is true in the case at bar, where the tax is entirely out of proportion to the real net operating income of the railroad, and the real relevance of this disproportion is that it indicates a purpose to tax the commerce itself, rather than the local privilege.

The facts at bar correspond closely to those of the *New Jersey Bell Telephone* case. In actual operation, and under

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judicial sanction, the tax here being litigated is in addition to and not in substitution for a property tax. Moreover, it is measured by a quantity (gross receipts) which bears no reasonable relationship to the taxable subject—namely, the local franchise privilege—since the tax base indiscriminately includes receipts from both interstate and local carriage. We respectfully submit that the *New Jersey Bell Telephone Company* case requires reversal of the judgment of the Supreme Court of New Jersey.

Of course, in addition to showing the striking coincidence between the facts of the case at bar and the facts in *Galveston Railway* and *New Jersey Bell Telephone*, it is necessary to show an identity of principle as well. We submit that the relevant rule is this: A state may not levy any tax, apportioned or otherwise, upon gross receipts from interstate commerce. This is clearly true where the state lacks a taxable subject, and seeks baldly to tax the right to engage in interstate commerce within its borders. E.g., *Joseph* v. *Carter & Weekes Stevedoring Co.*, 330 U. S. 422 (1947); *Ozark Pipe Line Corp.* v. *Monier*, 266 U. S. 555 (1925). But it is also true where, as in the case at bar, a state seeks to tax gross receipts under circumstances which make those receipts an inappropriate or unreasonable measure of the value of a taxable subject. In such case, formal or linguistic considerations are disregarded. A tax has the same forbidden effect upon commerce whether it is stated by the legislature to be levied on the privilege of doing interstate business or whether it reaches the gross receipts under the guise of a reasonable tax upon a permitted subject. In short, appellant urges that the New Jersey Railroad Franchise Tax, as construed and applied, imposes a direct burden upon interstate commerce.

The decisions of this Court in *Western Livestock* v. *Bureau of Revenue*, 303 U. S. 250 (1938) and *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U. S. 33 (1940) have led a number of commentators to believe that the "direct burden" doctrine has been sapped of its vitality. None-

theless, appellant submits that subsequent decisions of this court have re-affirmed that doctrine upon several occasions. In *Joseph* v. *Carter & Weekes Stevedoring Co., supra,* this Court specifically noted that *Western Live Stock* and *Berwind-White* had not impaired the authority of *Puget Sound Stevedoring Co.* v. *Tax Comm'n,* 302 U. S. 90 (1937). Yet *Puget Sound Stevedoring Company* was a case decided entirely upon the "direct burdens" rationale, a rationale which was further elaborated, and shown to be based upon practical considerations, in the *Carter & Weekes* opinion.

Again, in *Freeman* v. *Hewit,* 329 U. S. 249 (1946), this Court struck down a state gross receipts tax, in one particular application, on the ground that it imposed its burden upon the taxpayer for no other reason than that he had engaged in an interstate commercial transaction. Again in that case, the opinion of the Court pointed out that the "direct burdens" doctrine was evolved in order to meet the difficulties inherent in a federal system. The prohibition against direct tax burdens upon commerce was there viewed as but one application of the broader principle that the Commerce Clause, at least in the absence of Congressional permission, of its own force forbids certain types of state regulation upon interstate transactions. This principle is designed to leave Congress a free hand in the area of commerce, and to permit the development of a national system of trade—if need be without the aid of Congressional legislation—unhampered by the policies of the several states.

D.

The Question Presented by Appellant is not Foreclosed by any Decision of this Court.

Appellant has shown that two decisions of this Court require reversal of the judgment of the Supreme Court of New Jersey, and that the practical validity of the doctrine upon which those cases rest has been recognized by this Court in recent decisions.

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The only case which might be urged as justification for the dismissal of this appeal is *Central Greyhound Lines* v. *Mealey*, 334 U. S. 653 (1948). Some question as to the scope of that decision is raised by the dissent in *Interstate Oil Pipe Line Co.* v. *Stone*, 337 U. S. 662, 669 (1949). Particularly in footnote 18, p. 680, the dissenting Justices appear to have expressed the view that the *Greyhound* case authorizes the imposition of apportioned taxes upon gross receipts from interstate transportation.

Nonetheless, there are a number of reasons why this Court should not regard that case as controlling the one at bar. First, because the proposition apparently asserted in footnote 18 is inconsistent, not only with the direct adjudications of this Court, but with the general tenor and language of the *Interstate Pipe Line* dissent as well. Secondly, because the *Greyhound* case, as argued and decided, apparently did not involve the issues and contentions presented by the case at bar.

Examination of the summary of counsel's argument at pages 1635 and 1636 of 92 L. Ed. indicates that the attack upon the New York statute was made in terms different from those now urged by appellant. The principal concern of counsel for the appellant in the *Greyhound* case was over the question of apportionment, and he virtually conceded that a properly apportioned gross receipts tax would be constitutional in that particular case. It does not appear, moreover, that counsel for Greyhound ever contested the appropriateness of the measure to the subject taxed. It seems to have been assumed by Court and counsel alike that an apportioned tax would be "a constitutionally fair demand by the state for that aspect of the interstate commerce to which the state bears a special relation." (334 U. S. at 661).

In the instant case, however, contentions of appellant go beyond the narrow ambit of the *Greyhound* argument. It is here contended that an apportioned tax, which in effect

reaches gross receipts, is invalid under the circumstances here shown for the reason that it bears no fair relation to the value of any constitutionally taxable subject. The contention we make draws into question, in a way which the argument of counsel for Greyhound did not, the present status of the "direct burden" theory of constitutional limits on state taxation. Inasmuch as recent decisions of this Court, *e.g., Joseph* v. *Carter & Weekes S. Co., supra; Freeman* v. *Hewit, supra,* applying the "direct burden" concept have recognized the inherent soundness of its underlying policy, we respectfully submit that the instant case should receive a full hearing, and that this Court should consider whether or not, upon the facts here shown, the tax under attack is unconstitutional.

This Court recently said that in the field of state taxation under the Commerce Clause,

> "... opinions must be read in the setting of the particular cases and as the product of preoccupation with their special facts."

Freeman v. *Hewit,* 329 U. S. 249, 252 (1946).

In light of this rule of decision appellants respectfully submit that the *Central Greyhound* case does not control the case at bar. The decisive elements in the case at bar simply were not urged or considered in the *Greyhound* case.

POINT III

Conclusion

Appellant respectfully submits that it pointedly drew into question before the Supreme Court of New Jersey the validity of a state statute as construed and applied. The State Supreme Court decided in favor of that statute's validity as against a claimed Federal right. Further, the

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questions of Federal constitutional law urged are substantial. Precedents of this Court, and a principle of decision which has consistently been given effect by a majority of the justices of this Court, would seem to require that the judgment appealed from be reversed. We submit therefore that the jurisdictional requirements of Section 1257 (2) of the Judicial Code, 28 U. S. C., and of Supreme Court Rule 12 have been satisfied. Appellant therefore respectfully urges that the Appeal be retained.

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